DOW THEORY LETTERS INC.

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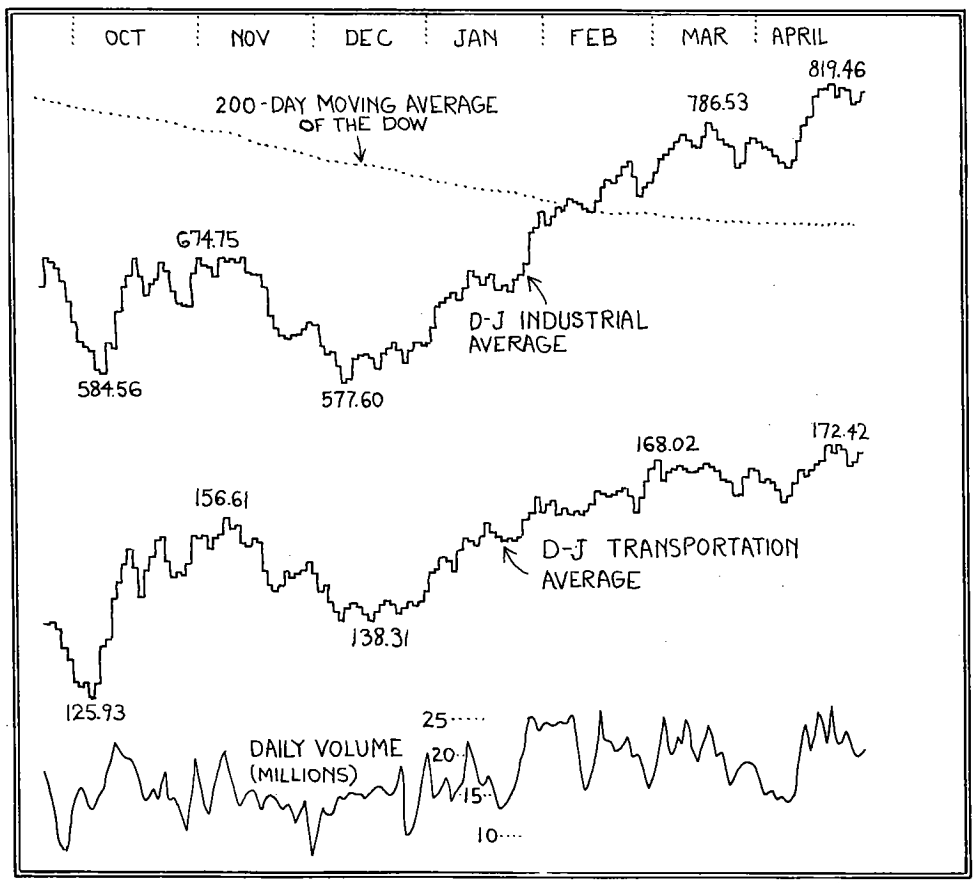
THE PICTURE: Each day I receive a number of Letters from people who ask for advice on this or that stock. I usually enter a few remarks on the margins of the letters and return them, but it's a most frustrating experience for me. The fact is that very few people benefit from the advice of another. Let's face it, I could provide a running portfolio of ten to twenty stocks with some sort of buy and sell "signals." But in the end it would be an exercise in futility.

Why, what's wrong with that idea? Here's what's wrong. Among my subscribers are many of the wealthiest individuals in the nation, some of the best minds, some of the largest corporations, some of the leading banks and institutions. That sounds interesting, doesn't it. Well, how about this? I have a subscriber who is a minister in a West African leper colony, I have a subscriber who runs a ranch in the middle of Wyoming, I have subscribers from every continent, every state in the Union and in every walk of life. There are housewives in Juneau and resort owners in Miami, textile salesmen in New York. In other words, it's a very varied (and I might add, fascinating) list of people and places.

What the devil is a New York bank going to do with a supervised list of 15 stocks? And how do I know whether a broker in Fresno is going to buy US Steel options, recommend the common to his customers, or put 3,000 shares of it in a pension plan that he manages? In other words, I have found over the years that the best thing I can do for anybody if provide my own analysis, my own thoughts, my own concepts, my own way of reading the market. But I'll be damned if I can sensibly provide thousands of investors and money managers with specific advice and specific buy and sell signals on a specified list of stocks. Furthermore, what may suit me (which is usually a good, reasonably safe profit) may not suit a pension fund manager or a man with a half million dollars of income per year.

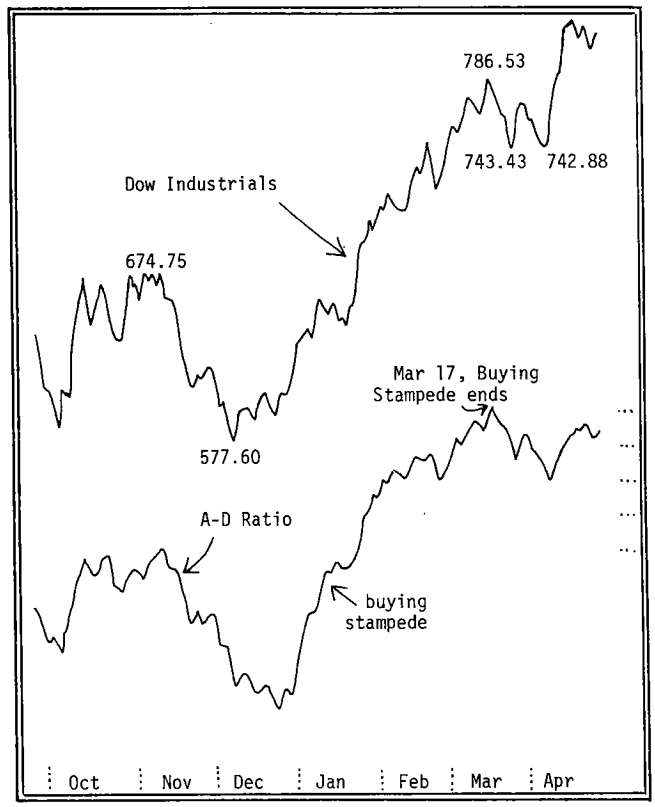
Now I'll finish my thesis with one final statement. I have never seen one man profit over any reasonable length of time by simply following the advise of another. I have never seen a situation in which one advisor or analyst was handling money for another man without that relationship ultimately falling apart due to disagreements or strains. This business deals with too many variables, too many objectives. It's too tough and too frustrating. I guess in the end it's like a democracy; either the people take responsibility for their part in the system or the whole thing goes under.



THE MARKET: There are corrective forces now "working on" the market, trying to edge it down, hold it back, seeking to let out some of the speculative steam that has built up over the past few months. But the pressure under a bull market isn't easily "popped," and a fighting bull doesn't drop to his knees with the first few thrusts of the lance. All of which is another way of saying that since mid-March the market has been beset by a number of technical problems, none of which (so far) has been able to push the bull into a full-scale secondary reaction.

Subscribers should remember that according to Dow Theory, a trend once established, is taken to remain in force until proved otherwise. In later pages I submit a list of a few of my personal worries about this market. But as I've written before, a bull market climbs a wall of worries, and my worries are probably just a few more bricks in the bull wall.

On Thursday, April 17, the Dow Industrials rallied to a 1975 high of 819.46 (see page 1 chart). The next day (April 18) saw a sharp decline, followed on Monday (April 21) by another rally. The April 21 move took the Transports to a 1975 high of 171.42, but inexplicably, Industrials refused to confirm. This was followed immediately by the 11 point Dow decline of April 22.



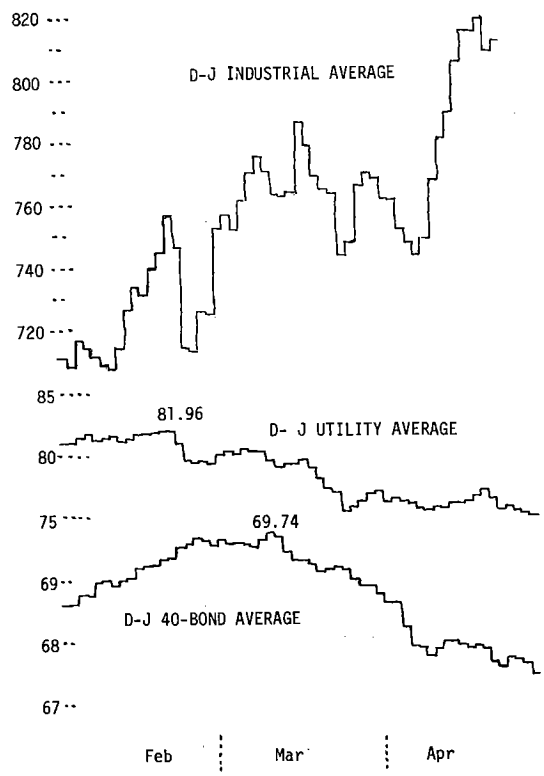
"What about the Transport bettering of the much-vaunted 168.02 level?" you ask, "Wasn't that a signal for much higher prices?" My answer is that an upside confirmation is always a hopeful sign. But we must also remember that sooner or later every advance comes to an end, and this is the reason that I remind subscribers that each successive confirmation by the Averages holds progressively less validity. Finally, there must be a confirmation that will arrive just before the top. At that point, amateur traders will complain loudly that "Dow's Theory doesn't work any more." But they will simply be over-working the confirmation thesis, while ignoring the adage that states that "No tree grows to the sky."

Perhaps it is a bit early to say this, but it does seem that the various Averages and indicators are slowly getting out of gear on this advance. The fact is that the advance-decline ratio (see accompanying chart) recorded a peak on March 17, and the price of the average stock has not been higher since. Daily new highs on the NYSE topped out the same day (March 17) at 393. Despite this, upside momentum continues (as it usually does) far past the early indicator peaks, and new 1975 marks were set by the Industrials on April 17 and by Transports on April 21.

On April 24 (Friday) a new rallying phase got underway with the targets being the 819.46 (Industrials) peak of April 17 and the 171.42 (Transports) peak of April 21. A push above 819.46 with Transports confirming would be particularly significant because (see last Letter) such action would represent a fairly convincing hurdling of the 50% level of the entire 1973-74 bear market decline. Should this occur, I feel that it would be a great technical plus for Wall Street, and we could, under those circumstances, see the market suddenly turn much more speculative.

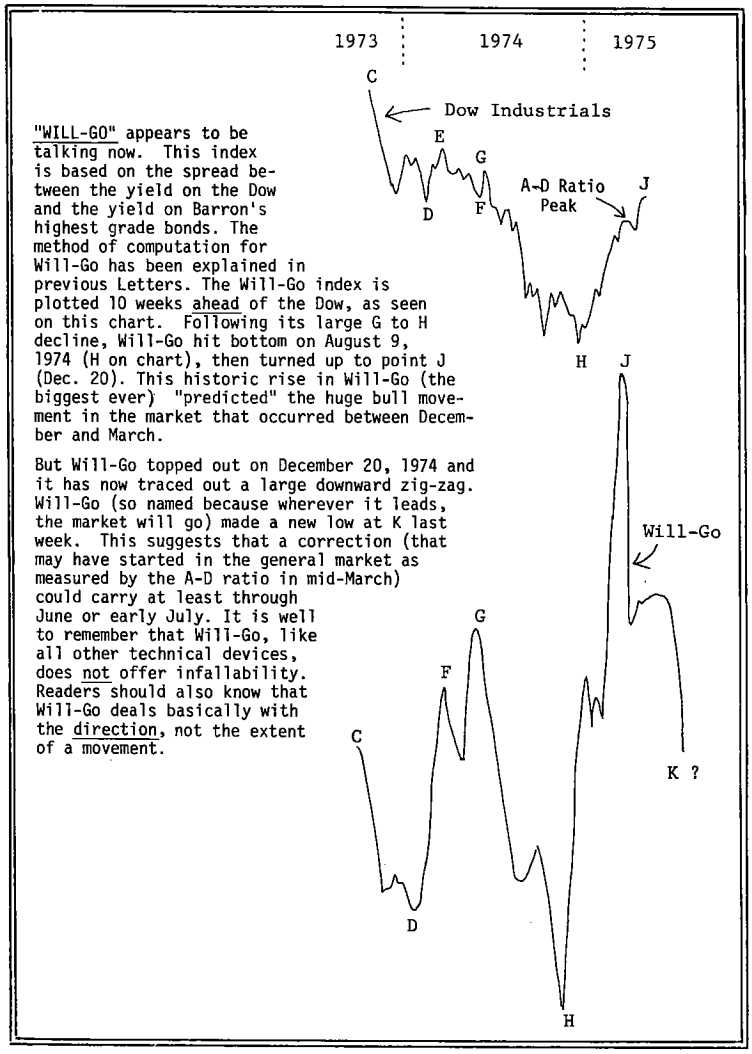
One of the technical aspects that has prevented me from becoming more bullish on the intermediate term market picture is the steady divergence in the two money-oriented Averages, the D-J Utility and the D-J 40-Bond Averages. Veteran subscribers know that I always consider a pronounced downtrend in both the Utilities and Bonds to signal a negative background for the market (regardless of the pattern in the Industrials and Transports).

I don't think most investors are aware of it, but the Utility Average turned down of February 21 (see accompanying chart) at 81.96. The Utilities were joined by the Bond Average, when that Average topped out on March 11. Since then those two important indicators have headed almost uninterruptedly down. Last Friday (April 25) Utilities and Bonds both closed at new lows for the move. Utilities at 75.03 (lowest level since early January) and Bonds at 67.47 (Bonds also at their lowest level since January). At best, I take this as a caution signal for the general market.



Conclusion: Without confirmation by the A-D ratio, the daily new highs, the Utility Average, or the Bond Average, the character of the advance has become somewhat ragged. Nevertheless, in a strong bull market the tide is often able to sweep stocks higher (at least for a while) despite technical problems and despite non-confirmations. It is also worth noting that the market has now split into two tiers with the institutions obviously carrying the ball from the early "value-oriented" investors. Thus we see the heavily capitalized stocks such as Steels, Chemicals and Aluminums moving up while the Ogdens, Kiddes, Uniroyals and GAF's languish. A decisive push above 814.65 (the halfway level of which I've been writing so much) with the other Averages and indicators moving in an upward direction (in other words, at least following the Dow) would obviously be bullish, and such action would set the stage for renewed action in the non-Dow and secondary issues.

WORRIES: Back in Letter 624 I presented a whole series of worries that I thought were besetting investors regarding the stock market. I also included refutations for each of those worries. So far, the refutations seem to have been correct. Now, just for a novelty, I'm going to present a few of my own worries.



"WILL-GO" appears to be talking now. This index is based on the spread between the yield on the Dow and the yield on Barron's highest grade bonds. The method of computation for Will-Go has been explained in previous Letters. The Will-Go index is plotted 10 weeks ahead of the Dow, as seen on this chart. Following its large G to H decline, Will-Go hit bottom on August 9, 1974 (H on chart), then turned up to point J (Dec. 20). This historic rise in Will-Go (the biggest ever) "predicted" the huge bull movement in the market that occurred between December and March.

But Will-Go topped out on December 20, 1974 and it has now traced out a large downward zig-zag. Will-Go (so named because wherever it leads, the market will go) made a new low at K last week. This suggests that a correction (that may have started in the general market as measured by the A-D ratio in mid-March) could carry at least through June or early July. It is well to remember that Will-Go, like all other technical devices, does not offer infallability. Readers should also know that Will-Go deals basically with the direction, not the extent of a movement.

(1) I wrote in the last Letter (page 6) that what the market does at the halfway level of a preceding major advance or decline is important. I said that 814.65 was the 50% level of the entire 1051.70 (1973) to 577.60 (1974) decline. Therefore, what the Dow did at 814.65 would be most significant. Last week the Dow pushed slightly above the halfway level on one single day (819.46 on April 17), then promptly dropped under the halfway or 814.65 level again. Of course, a new advance could take the Dow decisively above 814.65, but so far that level has managed to halt the Dow on each fresh assault. So, let's see what the new week brings.

(2) Over the past ten years (including, of course, 1973 and 1974) institutions have made approximately a 1% return on invested capital. That's a very bad record, but they did have the worst bear market in 40 years to contend with. Meanwhile, the money market is now very attractive. Treasury notes yield above 8%, some municipals (free from Federal taxes) yield above 8%, and the best I see ahead for the money market is a period of relatively stable conditions. The worst I see is a forthcoming expansion in business with an accompanying rising level of interest rates.

All this is reflected in the downward trend of the Bond and Utility Averages, the "Will-Go" Index, the stock-bond yield spread, etc. Subscribers should remember that with the yield on money instruments as high as they are today, you are speculating when you buy a stock to an extent that was not envisioned a few decades ago. In 1942 or 1950 you bought a good stock yielding 8% vs. a good bond yielding 3.5%. This was a huge yield incentive in favor of the stock holder. That yield incentive does not exist today. Today one buys stocks because he hopes they are real values, he hopes earnings will increase, he hopes the price of the stock will increase, and he hopes they are a hedge against inflation.

At 8% interest (which many bonds now provide) money doubles in ten years. At 10% money doubles in eight years. Those are powerful arguments for any profit-sharing or pension plan. A stock, of course, can double in a year or six months or a month. But the institutions know that, and their 10-year record hardly reflects their skill or judgment.

Moral: If the market looks uncertain today, you can move out and get a fat, risk-free 8% on an almost (credit) risk-free US Treasury note. I don't think most people realize that. But 8% on Government paper should go a long way towards satisfying even greedy investors. We're in the area where any decline in bond prices will act as a sharp brake on the stock market.

(3) The Dow is now up so strongly that it must either correct — or move up into a kind of "blow-off" spike. Mind you, I'm not saying that the Dow can't spike up from here, push through 900, even 1,000. In a primary bull movement the Dow and the market can do anything. But spikes make me very nervous. First, there's always the aftermath, and it's never pleasant. And second, I start wondering what the market is telling us.

A spike from here would be indicative of a very frothy and speculative situation in which buyers were chasing stocks willy-nilly, literally panicking to get "into the action." At the same time a spike formation here would imply a massive short squeeze with wholesale margin calls forcing the shorts to the wall. All of that is very exciting, but personally, I could live without it (and I think Wall Street could do very well without it too).

(4) It is very possible that the market is now discounting a period of rampant inflation, a period that could begin later in 1975 or even in 1976. Business, though sluggish now, could pick up as summer or fall arrives. And with the huge deficits and poten-

tial massive build-up in the money supply, even a mediocre pick-up in business could be accompanied by the worst inflation yet. The stock market may be jumping the gun on this situation.

All of which brings me to an interesting concept. Everybody wonders why gold isn't going sky-high in view of the coming deficits and possible inflation. But from its low of $35 in 1970 to its recent 1974 peak of $195 gold appreciated 457%. Now I'd call that getting in line with inflation, wouldn't you?

Think about this. In 1932, at the bottom of the Great Depression, gold sold for $20.66 an ounce, and the Dow was at a fantastically depressed 41.22. Thus the ratio of the Dow to gold was 2.0, which meant that the Dow was selling for only twice the price of gold. In a phrase, the Dow was dirt cheap in 1932.

Now let's up-date the study. At the December, 1974 market lows, the Dow as 577.60 and gold sold for $195. That meant that the Dow as priced at only 2.9 times the price of gold. In other words, in late-1974 the Dow and common stocks in general were the cheapest things around! And I said so at the time.

Next, the Dow and the market headed up, literally exploded, while gold (which had already made a massive inflationary move) dropped 15% to today's price in the $160's. How does this compare with history? Following the 1932 lows, with the Dow-gold ratio at 2.0, the market headed higher. By 1937 the Dow had advanced to 194 (up 373%), and the Dow-gold ratio had risen to 5.5. Today, with the Dow at around 820 and gold around 168 we have a Dow-gold ratio of 4.9, just below the ratio that existed at the 1932-37 bull market highs.

As I see it, there's a strong possibility that gold, in rising 457% from its 1970 price of $35 per ounce, has already made the greatest portion of its upward adjustment for inflation. But what about the stock market? That is the burning question, and my answer is that the market may be rushing up to discount a new round of inflation, but there is an "extra added ingredient" today. That extra is the probability that Wall Street is now running the "only game in town." Business is rough today, and only very selected companies are doing well. Real estate is hardly offering the ripe melons it did a few years ago. Expenses, wages, materials, are high today, and productivity is very low. Which is another way of saying that it is exceedingly hard to find a new business or enterprise to put your money into. But there is the stock market with its juicy collection of stocks, many still down 70%, 80% and even more from their former highs. And there is real upside action on Wall Street for a change. So that's an almost irresistible combination, bargains on Wall Street and a hot stock market! And that is what we've been seeing.

Another definite "kicker" is the fact that the institutions were not expecting a bull market, and they have been caught short of stocks. They are now rushing in to fill the larders. Who's selling them the shares? In my opinion, large individual investors, traders, many of the same people who bought during the latter part of 1974 and early 1975. Why are they selling? They like the idea of quick fat profits, they feel safer with some money on the sidelines after a 250 point Dow rally, they consider the "first play" of 1975 to be over, and they want to watch the show from the sidelines for a bit while they get their bearings.

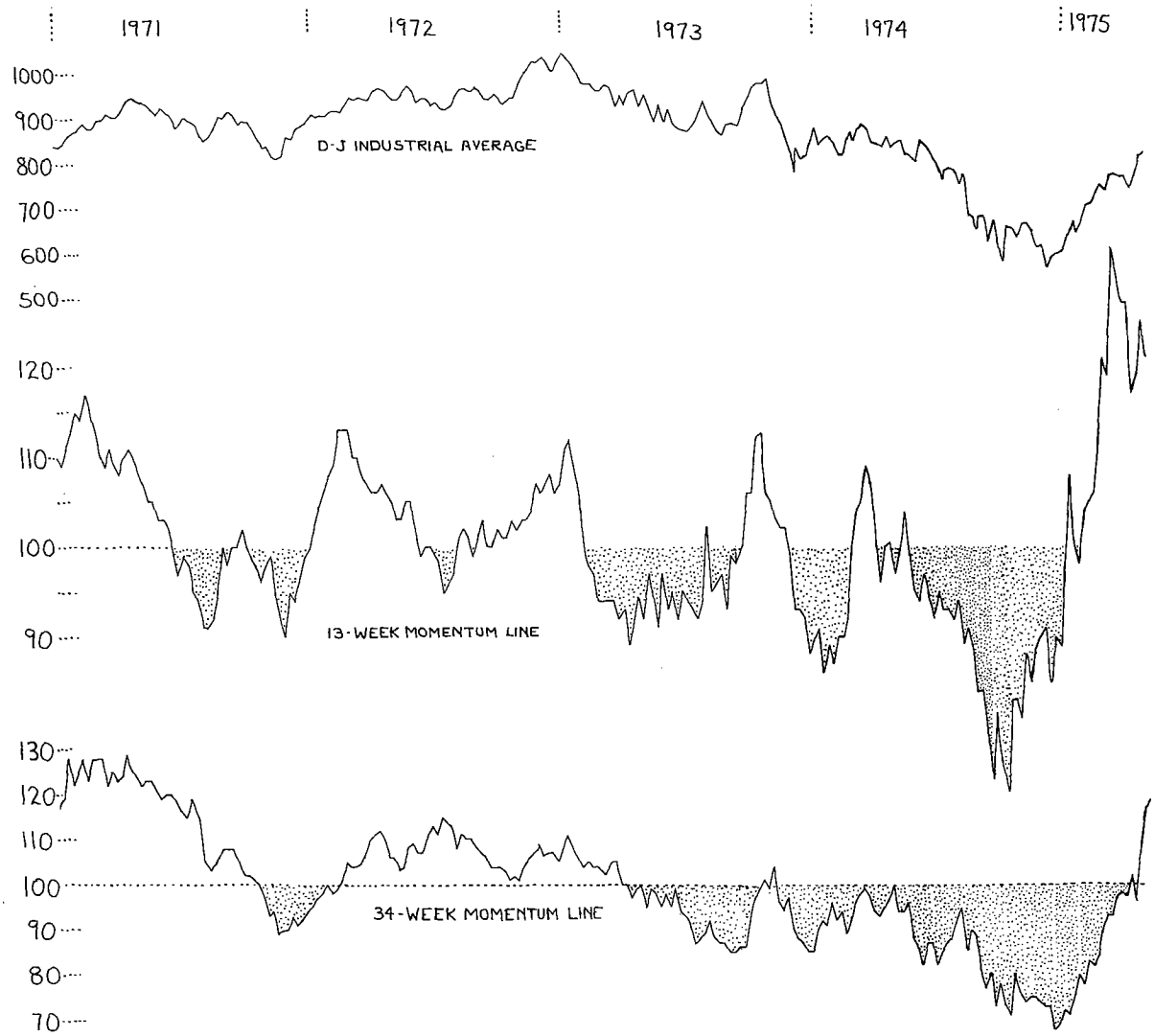
DOW MOMENTUM: (See chart, page 5). As discussed in all recent Letters, the general market is now lagging while the Dow Industrials and the Dow-type stocks have been doing the upside work. Therefore, if the market is to correct it will be a question of whether (and when) the Dow chooses to follow the rest of the market to lower levels. When the advance-decline ratio records a peak unconfirmed by the Dow, it is always a question of whether the Dow will drag the majority of issues up to a new A-D peak (in other words, an A-D confirmation) or whether the majority of issues, as represented by the A-D ratio, will drag the Dow down. The latter turn of events is the usual expectation, but as I have so often said, "Anything can happen on Wall Street."

Since strength or weakness in the Dow itself is now the critical appraisal question, let's turn to Dow momentum. I last reviewed the 13-week and 34-week Dow momentum lines in Letter 623. At that time the 13-week or intermediate term momentum index was bullish but quite extended, and the long-term or 34-week momentum line was just about to turn bullish.

As of this writing, the 34-week Dow momentum line is at 119, its highest level since March, 1971. This is a bullish omen for the long-term, but the near-term fate of the market is more geared to the 13-week momentum index and that is what I want to examine now.

Referring to the chart, we see that 13-week momentum peaked at an explosive reading of 133 many weeks ago. Since then, it has dropped to a low of 117 (in March), then rallied to 125 two weeks ago. Last week, on my latest reading, the 13-week momentum sank to 121. I compute that the Dow must hold above 815 this week (the week ending May 2). If it does not, if the Dow closes at 815 or lower, we will have an important downward zig-zag pattern in the 13-week momentum index, and I would take this as the beginning of the first correction in the Dow and its upside momentum since December, 1974.

Since the majority of the market has been lagging and has been held up only through strength in the Dow, it would pay us to be cautious on any breakdown of Dow momentum during the period ahead. For if the Dow heads down, then the rest of the market could easily outperform the Dow on the downside. That would constitute the bad news. The good news would be that such action would probably furnish subscribers with another "buy spot" in which to add to commitments or (for those who have moved to the sidelines) to take a second position in this bull market.

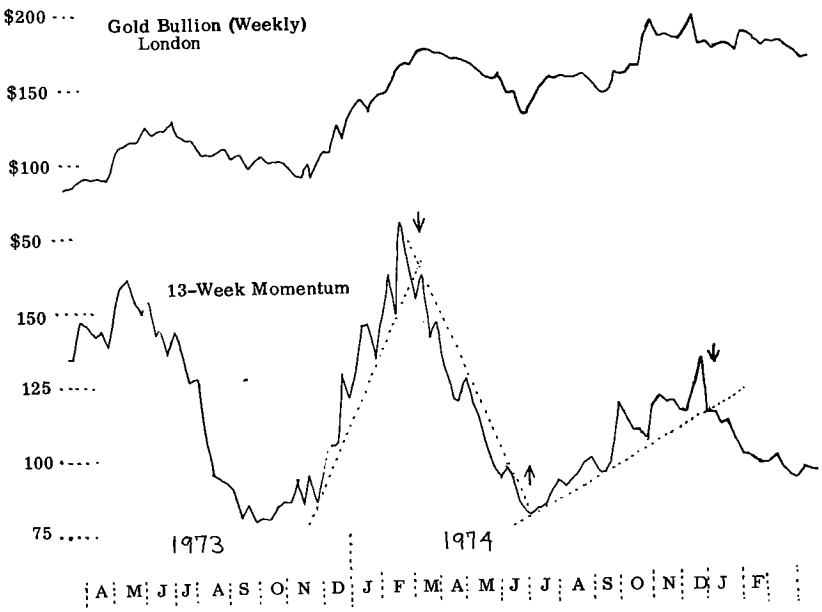


GOLD: My gold momentum chart (page 6) shows gold momentum in a shallow sideways move with a downside bias. Since most of the intermediate momentum swings in gold (refer to the chart) consume around five to six months, and since this down-move is in its fourth month, we might expect gold momentum to hit bottom in May or June. Note that the decline in momentum since December has been fairly weak, perhaps in reaction to the weak momentum on the upside during July to December, 1974. Does this shallow trend in the gold momentum swing since mid-1974 mean that the swings in the gold price are also going to be shallower? That could just be true, in my opinion.

Which is fine, except for one thing. As I warned in a report a month ago, costs at the gold mines are now rising rapidly. Last week I talked to John McFalls, publisher of Value-Trends (3838 48th Ave., NE, Seattle WA 98105). John is one of the nation's top experts on the S. African mines. He told me that average costs at the S. African mines rose roughly 12½% in the 1974 fourth quarter over the third quarter. And he said that we would see at least a comparable jump in costs in 1975's first quarter over the 1974 fourt quarter! John also said that a new wage boost is slated for June at the mines. Furthermore, according to Gold Mining Newsletter (15 Wilson St., London EC2M 2TR, England), labor (employment) at the mines is now only 78% of requirements.

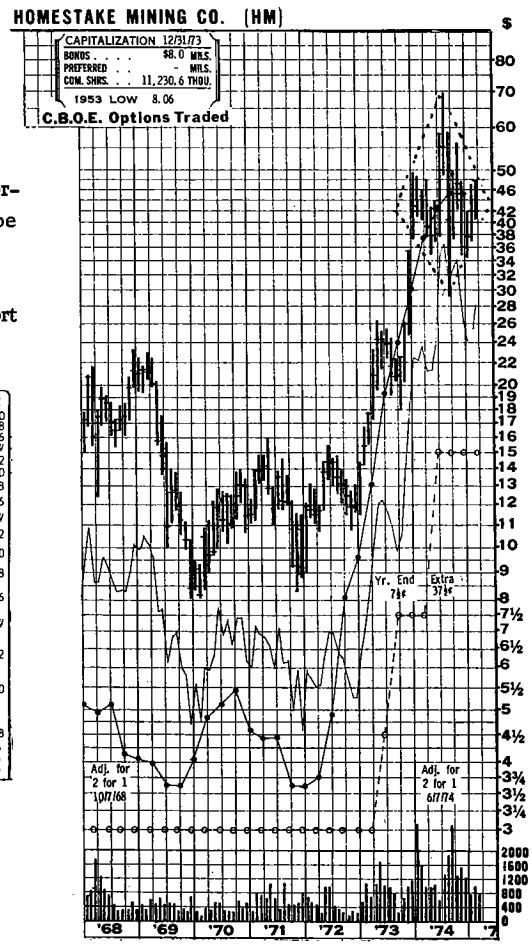
My chart of the gold bullion/gold share ratio shows this index now moving up in favor of bullion over gold shares, and this chart of Homestake might be the clue as to what is ahead for the shares (chart courtesy of Security Research, 208 New bury St., Boston, MA 02116). On this monthly chart (that I trimmed to save space), we see that HM has traced out a rare "diamond pattern" that is actually a variation of the "head-and-shoulders top." As I see it, it is a distribution pattern. However, on my daily chart of HM (not shown) it is clear that as long as HM holds above 40, there is hope that all may somehow blow over. Last week, however, the relative strength line on HM broke to a new low, below even the crash low of September, 1974! I do not view that action as particularly hopeful for the gold shares. It appears to me that unless the gold shares sink to important new bear market levels (in other words, to super-bargain levels), the way to play gold is going to be with bullion, not shares.

STOCKS: The current issue of Barron's contains a most informative article on the textile industry. This industry is most depressed, and its stocks, on average, topped out nine years ago in 1966. This monthly chart by Horsey, Salisbury, MD 21801, shows the great bear market in the textile group, a bear market that wiped out 70% of the value of the average textile stock.



I have included letters A, B, C to show that in Elliott terms, the bear market is probably completed in the form of the classical Elliott A-B-C decline. The C wave has been broken down into five waves with the fifth wave broken down again into another five waves — all signs of a drastic bear market with an extended final or C wave. Where these C waves are extended, we often see a violent recovery.

In previous Letters I recommended J.P. Stevens, second largest entity in the American textile industry. If I were to pick a package of three textile stocks for a recovery, I would pick Burlington, Lowenstein, and again Stevens. Dividends have been cut on all three, and the stocks will probably cover their lower dividends fairly well. The recovery potential in these three stocks is large, but remember, this is not a timing recommendation, it is a recommendation on selections. All three stocks are still in basing formations, althought if you will note on the weekly Quote charts, Burlington may be out-running itself and could correct back to its 10-week moving average (at 21) while Stevens is forming a most impressive base pattern. Lowenstein, from the chart standpoint, is having a few troubles, but this stock should have strong support in the 9 to 10 area.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CAPITALIZATION 12/31/73
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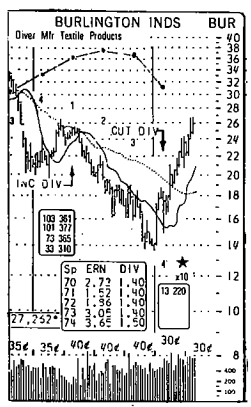
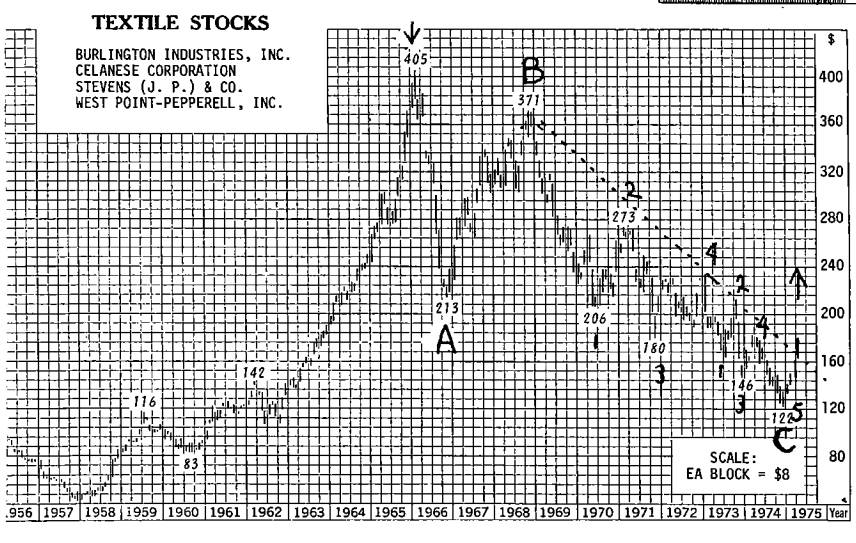
PREFERRED . . - MILS.
COM. SHRS. . . 11,230.6 THOU.
1953 LOW 8.06
C.B.O.E. Options Traded
Yr. End 75¢
Extra 37½¢
Adj. for 2 for 1 10/7/68
Adj. for 2 for 1 6/7/74
'68 '69 '70 '71 '72 '73 '74

NOTES: The chart books of the advance-decline ratio (daily, 1930 through 1974) will be mailed out this week and next. New readers who wish to order these please send $27.50 check ($29.15 if you live in Calif.) payable to Dow Theory Letters, Inc. I believe these chart books will provide an historical perspective on breadth and the Dow which has not been available to most students and analysts before.

Textile stock charts courtesy of Quote, PO Box 213, Wichita KS 67201.




TEXTILE STOCKS
BURLINGTON INDUSTRIES, INC.
CELANESE CORPORATION
STEVENS (J. P.) & CO.
WEST POINT-PEPPERELL, INC.
SCALE:
EA BLOCK = $8
1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 Year